

Introduction to Accounting

1. What is the purpose of Accounting Information? What are the main qualitative characteristics of accounting information?

Financial transactions, which occur in every business, make up the bulk of accounting information. Each business, large or small, should have a process for accurately recording accounting information. It is essential for good decision-making. A large company might have several accountants or staff to record and measure financial information. A smaller shop owner might produce this information himself or hire an external accounting firm.

Qualitative characteristics: (REDMC)

Recordable: To produce useful accounting information, financial transactions must be recordable. A transaction must take place to be recorded. Depending on the accounting method used, a transaction can be considered to have taken place when revenue is earned or expenses are incurred, even if no payments have been made or received.

Evaluation: Performance evaluation for an individual can be based on accounting information for transactions that were under that person's control. For example, a purchasing agent might be responsible for negotiating prices on raw materials. The actual cost of purchases made by that agent would form the basis for his evaluation. The local manager of a division might be evaluated based on the profits earned by that division. An income statement for that division would form the basis for her evaluation.

Decision-Making: Accounting information can be used for decision-making. One type of decision is whether a company should make a component itself, or purchase the part from an outside supplier. Another type of decision would be whether the company should accept a special order at a lower price. For either decision, financial data must be gathered and compared. Accounting information is relied upon to make the best decision.

Measurable: Accounting information must be measurable. If there is an invoice, a check or a contract, the Taka amount is easily determined. Without any document listing the Taka amount, an accountant must make an estimate using the best information he has available. He should clearly document her method for arriving at the estimated Taka amount.

Communication: Ultimately, accounting information is used to communicate. It is used to communicate financial results to external users, such as creditors or investors. Creditors use the information to determine how much credit to extend to the company. Investors determine whether they want to invest in the business. Accounting information is also communicated to managers and employees, who consider it in making decisions for future transactions.

2. Who are the users of financial statements?

Financial statements are intended to be understandable by readers who have "a reasonable knowledge of business and economic activities and accounting and who are willing to study the information diligently." There are different kinds of **users of financial statements**. The users of financial statements may be inside or outside the business.

Internal Users: ME The internal users of financial statements are individuals who have direct bearing with the organization. They may include:

Managers and Owners: For the smooth operation of the organization, the managers and owners need the financial reports essential to make business decisions. So as to provide a more comprehensive view of the financial position of an organization, financial analysis is performed with the information supplied in the financial statements. The financial statement is used to formulate contractual terms between the company and other organizations.

A variable of the financial statement like the **current debt to equity ratio** is important in deciding the amount of long term capital that would be required to be raised. The financial statements of other companies can also provide investment solutions to different companies. Sometimes it becomes difficult to decide the right field in which financial resources may be channelized. In such situations the financial statements of other companies provide the appropriate guideline.

Employees: The financial reports or the financial statements are of immense use to the employees of the company for making collective bargaining agreements. Such statements are used for discussing matters of promotion, rankings and salary hike.

External users (GIV): The external users comprise of:

Government: The financial statements of different companies are also used by the government to analyze whether the tax paid by them is accurate and is in line with their financial strength.

General Mass and Media: The common people as well as media also make part of the users of financial statements.

Institutional Investors: The external users of financial statements are basically the investors who use the financial statements to assess the financial strength of a company. This would help them to make logical investment decisions.

Financial Institutions: The users of financial statements are also the different financial institutions like banks and other lending institutions who decide whether to help the company with working capital or to issue debt security to it.

Vendors: The vendors who extend credit to a business require financial statements to assess the creditworthiness of the business.

Brief List of Users of Financial Statements

- Existing equity investors and lenders, to monitor their investments and to evaluate the performance of management.
- Prospective equity investors and lenders, to decide whether or not to invest.
- Investment analysts, money managers, and stockbrokers, to make buy/sell/hold recommendations to their clients.
- Rating agencies (such as Moody's, Standard & Poor's, and Dun & Bradstreet), to assign credit ratings.
- Major customers and suppliers, to evaluate the financial strength and staying power of the company as a dependable resource for their business.
- Labor unions, to gauge how much of a pay increase a company is able to afford in upcoming labor negotiations.
- Boards of directors, to review the performance of management.
- Management, to assess its own performance.
- Corporate raiders, to seek hidden value in companies with under priced stock.
- Competitors, to benchmark their own financial results.
- Potential competitors, to assess how profitable it may be to enter an industry.
- Government agencies responsible for taxing, regulating, or investigating the company.

- Politicians, lobbyists, issue groups, consumer advocates, environmentalists, think tanks, foundations, media reporters, and others who are supporting or opposing any particular public issue the company's actions affect.
- Actual or potential joint venture partners, franchisors or franchisees, and other business interests who need to know about the company and its financial situation.

3. Write Short notes: Balance Sheet, Income statement, capital Expenditure, revenue expenditure, capital income, revenue income

Balance Sheet: A balance sheet or statement of financial position provides a snapshot of a company's assets and liabilities at a given point in time. It also shows shareholders' equity, the net value of the company, by taking the difference between the company's assets and liabilities. The balance sheet is one of the four basic financial statements, and is the only one which applies to a single point in time (as opposed to a given period). Conceptually, the balance sheet is based on the accounting equation, which states that the total amount of assets must *balance* the total amount of liabilities and owner's equity: $\text{Assets} = \text{Liabilities} + \text{Owner's Equity}$. Hence the balance sheet is divided into these three primary sections.

Income Statement: A financial statement that measures a company's financial performance over a specific accounting period. Financial performance is assessed by giving a summary of how the business incurs its revenues and expenses through both operating and non-operating activities. It also shows the net profit or loss incurred over a specific accounting period, typically over a fiscal quarter or year. It is also known as the "profit and loss statement" or "statement of revenue and expense".

Capital Expenditure: Capital expenditures (CAPEX or capex) are expenditures creating future benefits. A capital expenditure is incurred when a business spends money either to buy fixed assets or to add to the value of an existing fixed asset with a useful life extending beyond the year. CAPEX is used by a company to acquire or upgrade physical assets such as equipment, property, or industrial buildings. Capital expenditure can include costs incurred in bringing a long-term asset to its final condition and location, such as legal fees, duties and carriage costs borne by the assets purchaser.

Revenue Expenditure: Revenue *expenditure* is a cost that you charge to expense as soon as you incur it. By doing so, you are using the matching principle to link the expense incurred to revenues generated in the same accounting period. There are two types of revenue expenditure:

- *Maintaining a revenue generating asset.* This includes repair and maintenance expenses, because they are incurred to support current operations, and do not extend the life of an asset or improve it.
- *Generating revenue.* This is all day-to-day expenses needed to operate a business, such as sales, rent, office supplies, and utilities.

Capital income: Capital income is income that comes from capital, which is to say, comes from wealth itself, rather than any specific production or direct work. Examples of capital income are stock dividends or any sort of capital gains, as well as income an owner gets from a business they own but not from the work they do there. The phrase capital income may also be used to mean any revenue that is used for

capital expenditures, although this sense is not as commonly used. Capital income can be classified either as a capital gain or capital loss, depending on whether there is a net gain or loss. For example, if a piece of land is purchased for Tk. 500,000, and a year later is sold for Tk. 600,000, a capital gain is said to have occurred of Tk. 100,000, which is included in the seller's capital income for that year. If, on the other hand, the land was sold for Tk. 400,000, a capital loss of Tk. 100,000 is said to have occurred, and so there is no capital income.

Revenue income: Revenue is the amount of money that is brought into a company by its business activities. In the case of government, revenue is the money received from taxation, fees, fines, inter-governmental grants or transfers, securities sales, mineral rights and resource rights, as well as any sales that are made.

Interactive question 3 -Page 13.